

## Section 2, Calculating the Ratios from the Balance Sheet and Income Statement

### Balance Sheet

Line		
1	Cash	\$ 190,000
2	Accounts Receivable	1,010,000
327		
4	Inventories	130,000
5	Note Receivable from Affiliate	200,000
6	Investments	330,000
7	<b>Total Current Assets</b>	2,010,000
8	Property and Equipment, net	500,000
9	Amount Due from Owner	170,000
10	Goodwill	80,000
11	Organization Costs	70,000
12	Deposits	60,000
13	<b>Total Assets</b>	2,890,000
14	Accounts Payable	200,000
15	Accrued Expenses	330,000
16	Current Portion of Long-Term Debt	120,000
17	Deferred Revenue	650,000
18	<b>Total Current Liabilities</b>	1,300,000
19	Long-Term Debt, net of Current Portion	330,000
20	<b>Total Liabilities</b>	1,630,000
21	Contributed Capital	440,000
22	Retained Earnings	820,000
23	<b>Total Owner's Equity</b>	1,260,000
24	<b>Total Liabilities and Owner's Equity</b>	2,890,000

### Statement of Income and Retained Earnings

Line		
25	Operating Income	\$ 9,700,000
26	Non-Operating Income	300,000
	<b>Total Income</b>	10,000,000
28	Cost of Goods Sold	6,800,000
29	Administrative Expenses	2,600,000
30	Depreciation Expense	60,000
31	Interest Expense	40,000
32	<b>Total Expenses</b>	9,500,000
33	Other: Gain on Sale of Investments	10,000
34	<b>Net Income Before Taxes</b>	510,000
35	Federal Income Taxes	153,000
36	<b>Net Income After Taxes</b>	357,000
37	Extraordinary Loss, net of Tax	800,000
38	<b>Net Income</b>	(443,000)
39	Retained Earnings, Beginning of year	1,263,000
22	<b>Retained Earnings, end of year</b>	820,000

$$\text{Primary Reserve Ratio} = \frac{\text{(lines } 23-5-9-10-8+(16+19)\text{)}}{32} = \frac{\$ 760,000}{\$9,500,000} = 0.080$$

$$\text{Equity Ratio} = \frac{\text{(lines } 23-5-9-10)}{13-5-9-10} = \frac{\$ 810,000}{\$2,440,000} = 0.332$$

$$\text{Net Income Ratio} = \frac{\text{(lines } 34)}{27+33} = \frac{\$ 510,000}{\$10,010,000} = 0.051$$

\*Long-Term Debt (lines 16+19) cannot exceed Property and Equipment (line 8) in this formula

### Section 3: Calculating the Composite Score

Step 1: Calculate the strength factor score for each ratio, by using the following algorithms:

Example (for Proprietary Institutions)

Primary Reserve strength factor score = 20 x\* Primary Reserve ratio result:  $20 \times 0.080 = 1.600$

Equity strength factor score = 6 x Equity ratio result:  $6 \times 0.332 = 1.992$

Net Income strength factor score = 1 + (33.3 x Net Income ratio result):  $1 + (33.3 \times 0.051) = 2.698$

If the strength factor score for any ratio is greater than or equal to 3, the strength factor score for that ratio is 3. If the strength factor score for any ratio is less than or equal to -1, the strength factor score for that ratio is -1.

Step 2: Calculate the weighted score for each ratio and calculate the composite score by adding the three weighted scores

Primary Reserve weighted score = 30% x Primary Reserve strength factor score:  $0.30 \times 1.600 = 0.480$

Equity weighted score = 40% x Equity strength factor score:  $0.40 \times 1.992 = 0.797$

Net Income weighted score = 30% x Net Income strength factor score:  $0.30 \times 2.698 = 0.809$

Composite score = sum of all weighted scores:  $0.480 + 0.797 + 0.809 = 2.086$

Round the composite score to one digit after the decimal point to determine the final score: 2.1

\* The symbol "x" denotes multiplication.